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How Do Pension Changes Affect Retirement Preparedness? The Trend to Defined-Contribution Plans and the Stock Market Decline of 2008–2009

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Our paper has two parts. Part I presents background information on pensions drawn from our forthcoming book, *Pensions in the Health and Retirement Study*. Using data from the Health and Retirement Study (HRS), trends in pensions are described among three cohorts: those ages 51 to 56 in 1992, (the HRS cohort); those 51 to 56 in 1998 (the War Baby cohort); and those 51 to 56 in 2004, (the Early Boomer cohort). Part II, entitled "What the Stock Market Decline Means for the Financial Security and Retirement Choices of the Near-Retirement Population," deals with the likely effects of the stock market decline on the wealth of those approaching retirement age. The analysis of wealth loss is based on data for the Early Boomer cohort collected in 2006. Effects on retirement are also analyzed.

Our findings suggest that although the consequences of the decline in the stock market are serious for those approaching their retirement, there is less reason for concern about the immediate adverse impact of the fall in the stock market than many suggest. Despite their closeness to retirement, and with the trend to defined-contribution (DC) pension plans notwithstanding, the average person approaching retirement age is not likely to suffer a life changing financial loss from the stock market downturn of 2008–2009.

Similarly, the likely effects of the stock market downturn on retirements have been greatly exaggerated. If there is any postponement of retirement due to stock market losses, on average it will be a matter of a few months rather than years. Counting layoffs, retirements may be accelerated rather than reduced.

Pension Coverage, Pension Value and Trends in Pensions

The background data in Part I show that pension coverage is much more extensive than is usually recognized. Coverage of those approaching retirement age comes not only from plans on current jobs, but also from pensions held in previous employment. In the most expansive definition of coverage, if pension coverage is measured at the household level, so that individuals whose spouse is covered by a pension are also said to be covered, over three-quarters of the households with a person ages 51 to 56 in 2004 are currently covered by a pension, or have enjoyed pension coverage in the past. This is in contrast to the usual measure of coverage, which typically reports that 50 or 60 percent of current employees are covered by a pension.

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Second, the background data also show that pension wealth accounts for 23 percent of the total wealth of the Early Boomer households.

Third, the trend to DC plans is readily apparent in the HRS data. However, detailed data on job and pension tenure by plan type also show that DC plans remain immature. As a result, almost two thirds of pension wealth held by those 51 to 56 in 2004 is in the form of a defined-benefit (DB) plan.

Fourth, reflecting major changes in the level and continuity of their labor force participation, women from the Early Boomer cohort are more likely to be covered by a pension than are women from earlier cohorts, and their pensions are more valuable than the plans held by women in the original HRS cohort.

Pension trends, in turn, play an important role in determining how the stock market decline of 2008–2009 affects those who are approaching retirement. The second part of our analysis deals with that issue.

The Retirement Age Population and the Stock Market Decline

The Early Boomer cohort, those 51 to 56 in 2004, was the group closest to retirement as the recession unfolded. As of 2006, their pensions accounted for 23 percent of their total household wealth. Because their DC plans remain immature, 35 percent of their pension wealth is in the form of a DC plan. In addition, 62 percent of DC pension wealth is held in the form of stocks. When direct stock holdings and stock holdings in IRAs are added to stock holdings in DC plans, in 2006 total stock holdings of the Early Boomer cohort average 15.2 percent of total wealth. This greatly limits their direct exposure to the decline in the stock market.

Many of the assets held by the retirement age population will cushion them against the direct effects of the stock market decline. Most importantly, in 2006 Social Security represents 26.1 percent of total household wealth of the Early Boomer population. Also of importance, although DC pensions have grown rapidly, for those approaching retirement age, DB plans covering the Early Boomer population account for almost two thirds of their total pension wealth.

When we examine the distribution of pension and Social Security wealth by wealth decile, the share of total wealth held in stocks rises from 1.5 percent in the lowest decile, to 22.6 percent in the highest (excluding the top 1 percent of wealth holding households). As a result, on average, even those in the highest wealth decile exhibit limited exposure to the stock market decline.

Small Changes in Retirement by the Retirement Age Population

The second part of our paper finds that despite speculation to the contrary, those approaching retirement are not likely to substantially delay their retirement in reaction to the stock market decline, probably postponing their retirement by no more than a couple of months. When the effects of layoffs are considered, and it is recognized that layoffs are likely to lead to increased rather than decreased retirements, the net effect of the downturn on retirement is likely to be very slight, perhaps encouraging earlier retirements on net. We also show that those approaching retirement are not likely to be greatly or immediately affected by the decline in housing prices. Nevertheless, the greatest worry is for those who lose their jobs, or are exposed to multiple hazards. Many of those most severely damaged by the recession will be individuals laid off from a long-term job while in their early fifties.

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